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October 30, 2013

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

U.S. Department of the Treasury
250 E Street, SW
Washington, DC 20219

Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

Subject: Proposed Rule (Release Nos. 34-70277), Credit Risk Retention - Federal Reserve Docket No. R-1411; FDIC RIN 3064-AD74; OCC Docket Number OCC-2013-0010; SEC File Number S7-14-11; FHFA RIN 2590-AA43

Ladies and Gentlemen:

On behalf of the more than 23,000 designated members, candidates and affiliates of the Appraisal Institute, the largest professional association of real estate appraisers in the world, thank you for the opportunity to comment on the Proposed Rule on *Credit Risk Retention*. The proposal contains several elements of concern that relate to collateral risk and appraisal, which we provide comment on below.

**Commercial Real Estate**
We support the proposed retention of appraisals for Qualified Commercial Real Estate, as real estate appraisals are a centerpiece of collateral risk assessment (Section .17, *Underwriting Standards for CRE Loans*). However, we remain deeply concerned about the proposed rule's treatment of maximum combined loan-to-value (CLTV) ratios as it relates to appraisals. If retained in the Final Rule, we believe the proposed lowering of CLTV based on capitalization rates, or overall capitalization rate (OARs), may unnecessarily constrain credit to higher performing properties throughout the country.

The proposed rule inexplicably fails to address concerns that we previously expressed to the agencies in 2011[1]. Generally, the proposed rule continues to espouse policies that illustrate a lack of understanding of the appraisal process. Specifically, the agencies are proposing to retain the requirement that the maximum CLTV ratio be lowered by 5 percent if the CRE property was appraised with a "low" OAR. The proposal goes on to state:

> *Generally, assuming a low cap rate will inflate the appraised value of the CRE property and thus increase the amount that can be borrowed given a fixed LTV or CLTV. Therefore, such a loan would have a maximum 60 percent LTV and 65 percent CLTV. In addition, to address the commenters' concerns about high cap rates, the agencies are proposing that the cap rates used in CRE appraisals be disclosed to investors in securitizations that own CRE loans on those properties.*

We disagree with the use of the terms "low" and "high" OARs as these terms are not adequately defined by the proposed rule. More importantly, the proposal inappropriately implies that properties with lower OARs lead to "inflated" market values. Further, we believe disclosure of OAR to investors is relatively meaningless on its own,

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[1] Available at http://www.appraisalinstitute.org/newsadvocacy/downloads/ltrs_tstmny/2011/ai-asfmra_risk_retention.pdf

especially without further information or context such as vacancy and collection rates and operating expense ratios for the subject and comparable properties.

First, if there is evidence to suggest the OAR is not supported by market information or contains an artificially high value, we question why such an appraisal would be accepted. If such circumstances exist, the Agencies should suggest reconsideration of the primary loan decision.

Second, without trying to defend improperly developed OARs, there are legitimate reasons that some OAR indications might be perceived to be low. OAR is simply the first year Net Operating Income (NOI) divided by the Value. There are some properties that legitimately have NOI increases in subsequent years which influence value and thus the OAR. One further example - if reserves for replacements (actually allocating annually for worn out capital, such as a roof covering or HVAC, which is very prudent) are included on the expense side, then the OAR could be lower because the risk of wearing out the roof, HVAC, or other similar component, has been appropriately addressed.

Lastly, in our view, current investor analysis in some property types (such as multi-tenanted, high rise office buildings) is moving away from OAR analysis and toward Discounted Cash Flow Analysis (DCF). DCF can account for operations that are not stabilized more efficiently than OAR analysis. Here, real balance is seen in properties that can produce positive cash flow compared to the debt service or Debt Coverage Ratio (DCR). Negative DCR's should be avoided in Qualified Loans. Appraisers can and should analyze valuation results in light of the indicated DCR found at OAR, and a qualified appraiser would do this. In this case, DCF information may be more important or credible than OAR information.

Alternatives to Arbitrary OAR Disclosures
In talking with users of appraisal services, we understand that clients often request appraisers to refrain from making arbitrary adjustments within the OAR. This is to avoid making adjustments to the OAR after becoming aware of an issue that was not previously accounted. We believe the agencies could provide similar guidance to lenders in the Final Rule and that this guidance would be preferred to making arbitrary disclosures and assessments about low or high OARs.

Further, concerns over the contents of appraisals can also be addressed by completing thorough appraisal reviews by qualified reviewers or by engaging a second appraiser prior to origination. As an alternative to the vague and undefined approach reducing CLTV where "low" OARs are found, we urge the final rule to incorporate provisions relating to appraisal review and second appraisals where questionable OAR results may have been reported rather than imposing a lower CLTV that may unnecessarily constrain credit being provided only to higher performing properties.

Finally, should the agencies elect to retain the OAR disclosure requirement; we suggest disclosure of vacancy and collection rates and operating expense ratios for the subject property and comparables, as this information is equally important as OAR information.

**Qualified Residential Mortgage**
We are disappointed to see the Agencies reverse position on residential collateral risk assessment by reversing the proposed written appraisal requirement for Qualified Residential Mortgages. Frankly, it appears the agencies are placating loan production elements of financial institutions by removing collateral risk requirements for QRM. This inappropriately places risk management in a secondary position. We disagree with this approach and believe that it may mark the reemergence of some of the same risky lending tactics that we saw in the past decade.

While the original proposal required a written appraisal for QRM, the new proposed rule drops it entirely. At the same time, the agencies profess to pay attention to collateral risk by adding a footnote that states:

> *The agencies continue to believe that both LTV and borrower credit history are important aspects of prudent underwriting and safe and sound banking.*

If the agencies truly believed that LTV is an important aspect of prudent underwriting and safe and sound banking, it would treat collateral risks equally, rather than relegating them to secondary status. It would also not create disparities in how risk management is conducted in residential real estate as compared to commercial real estate as collateral risks exist in both classes. Unfortunately, the proposed rule does this by establishing an appraisal requirement in one class (QCRE) and an exception in another (QRM).

We believe a borrower's ability to repay is an important risk factor, but collateral risk is equally important to safe and sound lending, especially the condition of the property and its position within the market. What happens when a roof needs to be replaced, or the home requires a new furnace or windows in the first 12-18 months of the loan? What is the risk to the property, and the lender, as a result of future overbuilding that would be identified if the lender used a well-developed fundamental market analysis as part of the appraisal requirement? The proposed rule does not produce "prudent underwriting and safe and sound lending."

Alternative Approach (QM-Plus)
We are heartened to see that we are not alone in our concern, as the agencies appear to have been divided on this issue. The proposed rule appropriately accepts comments on an Alternative Approach, which treats collateral risk far more seriously than the proposed rule. Without question, the Alternative Approach is preferable to the proposed rule as it relates to collateral risk assessment. Unlike the proposed rule, the Alternative Approach would require an appraisal, as was originally proposed by the Agencies, and it would retain a central position for LTV ratios within the QRM process. The Alternative Approach treats collateral risk equally with credit and capacity risk, as it should. The proposed rule explicitly places collateral risk assessment in a secondary position as it relates to other risk factors. As such, we strongly urge acceptance of the Alternative Approach by the agencies.

Thank you again for the opportunity to comment on the proposed rule. Should you have any questions or need additional information, please contact Bill Garber, Director of Government and External Relations, Appraisal Institute, at 202-298-5586 or bgarber@appraisalinstitute.org, or Brian Rodgers, Manager of Federal Affairs, Appraisal Institute, at 202-298-5597 or brodgers@appraisalinstitute.org.

Sincerely,

Appraisal Institute